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SIPDIS

STATE FOR EB A/S TONY WAYNE
STATE FOR WHA/CAN, EB/IFD, INR
STATE FOR WHA DAS WHITAKER
USDOC FOR 3000/ITA U/S RHONDA KEENUM
USDOC FOR 432/ITA/IAA/BASTIAN/RUDMAN/FOX
TREASURY FOR U/S (INTERNATIONAL AFFAIRS) TIMOTHY ADAMS
TREASURY FOR U/S (DOMESTIC FINANCE) RANDY QUARLES
TREASURY FOR PATRICIA BROWN
DEPT ALSO PASS USTR FOR J. MELLE AND S. CHANDLER
DEPT PASS SEC - MARISA LAGO
DEPT PASS FEDERAL RESERVE BOARD
DEPT PASS TO IRS - COMMISSIONER MARK EVERSON
WHITE HOUSE/NSC - KIM BRIER AND SUE CRONIN

SENSITIVE

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [PREL](#) [KPAO](#) [CA](#) [US](#)

SUBJECT: The Canadian Financial Sector: U.S. Life Insurers in Canada Complain of IRS Ruling 2004-75

Ref: (A) Toronto 2609 (B) Toronto 2638

Sensitive but Unclassified - Protect Accordingly.

[¶1.](#) (U) This cable contains an action request; see paragraph 9.

[¶2.](#) (U) This message is one in a series reviewing the Canadian financial services sector from a cross-border, North American integration perspective. In September 2005 the Toronto Financial Services Alliance sponsored roundtables for ConGen Toronto with industry sector experts in venture capital (ref (B)), banking (septel), securities (septel), and insurance.

[¶3.](#) (SBU) SUMMARY: During a September 27 financial services roundtable on the insurance sector held for ConGen Toronto, the Canadian Life and Health Insurance trade association (CLHIA) complained that IRS Ruling 2004-75 is "a real headache" for U.S. companies doing business in Canada because it imposes extra-territorial taxation on Canadians who receive benefit payments from U.S. insurance carriers. This effectively subjects them to double-taxation in both Canada and the U.S. The net effect is to reduce significantly the competitiveness of U.S. life insurers in the Canadian market place. Several written requests from both Canadian and U.S. trade associations to Canadian and U.S. authorities have so far not/not produced any results. END SUMMARY.

Background: Canada's Life Insurance Sector

[¶4.](#) (SBU) Established in 1894, the Canadian Life and Health Insurance Association (CLHIA) prides itself on being Canada's oldest trade association. Canada's life insurance industry is highly globalized, with more than half of the industry's annual premiums being generated outside Canada - C\$65 billion - compared to C\$58 billion within in Canada. The industry's biggest growth areas are wealth management and health insurance, with life insurance in relative decline and disability insurance growing only modestly.

[¶5.](#) (SBU) An industry trend among Canada's best known life insurance firms to demutualize (i.e., change their ownership structure from "member owned" to "shareholder owned") was completed in the late 1990s: Clarica, Manulife, Canada Life, and Industrial Alliance in 1999, and SunLife in 2000. Demutualization was followed by some limited merger activity that reduced the number of life insurers in Canada from 163 in 1990 to 105 in 2004. The most prominent mergers were SunLife's acquisition of Clarica (2002) and Great-West Life's acquisition of Canada Life (2004) - permitted by the federal government as compatible with its financial services sector dictum that "big shall not buy big." Frustrated with the federal government's no merger policy among big financial services providers, Manulife Financial, Canada's biggest insurer, bought Boston-based John Hancock Financial services in the spring of 2004 for US\$15 billion in the biggest Canadian cross-border financial services deal in history.

[¶6.](#) (U) The CLHIA counts 28 U.S. life insurance branches and 11 U.S.-owned subsidiaries among its

approximately 100 members. U.S. life insurance companies in Canada hold some 1 million policies with Canadians and pay annual benefits in excess of C\$2.75 billion to those Canadian policy-holders. U.S. members of CLHIA whose Canadian clients are double taxed as a result of IRS Ruling 2004-75 include State Farm, Met Life, American Income, Fortis Benefits, Combined of America, Knights of Columbus, and Prudential of America.

CLHIA Questions IRS Ruling 2004-75

17. (SBU) By far the biggest cross-border issue for the CLHIA is IRS Ruling 2004-75. The CLHIA representatives present at the September 27 roundtable held for ConGen Toronto asked for assistance in eliminating what it calls "inappropriate extra-territorial taxation of Canadians by the United States." According to the CLHIA, IRS ruling 2004-75 -- harms U.S. companies conducting business in Canada. As a senior CLHIA Vice-President explained, the U.S. Internal Revenue Service announced in June 2004 the extra-territorial application of withholding taxes to benefit payments from life insurance policies (and annuity contracts) issued to non-U.S. residents by foreign branches of U.S.-based life insurance companies. The effect of IRS Ruling 2004-75 is to subject Canadian residents, contracting in Canada with Canadian branches of U.S. companies, to U.S. taxes, even where those individuals have no U.S. property or other connection with the United States. While apparently intended to address specific problems in Puerto Rico, IRS Ruling 2004-75 was worded so that it applied on a worldwide basis. A subsequent amendment, Ruling 2004-97, has similar application.

18. (SBU) According to CLHIA, IRS Ruling 2004-75 creates a problem of double taxation of Canadian residents who receive benefits under policies with U.S. life insurers operating in Canada. In addition to paying U.S. withholding taxes, these Canadian residents already pay taxes on their benefits under Canadian law. CLHIA told us that all one million policies held by U.S. insurers with Canadian residents are affected. The dollar value of benefit payments subject to double taxation runs above C\$2.75 billion annually. Not surprisingly, the CLHIA and its U.S. counterpart, the American Council of Life Insurers, have contacted Canadian and U.S. authorities in order to limit the scope of these IRS Rulings, or exempt Canadian policyholders via an amendment to the Canada-U.S. Tax Convention. Written submission made in regard to IRS Ruling 2004-75 include:

--ACLI letter to IRS, July 21, 2004

--CLHIA letter to Len Farber (Canadian Dept. of Finance) et al., October 15, 2004

--CLHIA letter to Patricia Brown (U.S. Treasury), July 26, 2005

--CLHIA letter to Brian Ernewein (Canadian Dept. of Finance), August 8, 2005

(NOTE: Copies of these letters have been e-mailed to Embassy Ottawa and WHA/CAN desk officers. END NOTE).

Action request

19. (SBU) ConGen Toronto requests Department follow up with Treasury and the IRS to determine when U.S. insurance companies operating in Canada can regain the even playing field that they claim they have been deprived of by the extra-territorial provisions of IRS Ruling 2004-75.

List of Attendees

110. (U) The roundtable included the trade associations of Canada's life insurance sector (CLHIA), the Insurance Bureau of Canada (IBC), as well as prominent private sector stakeholders: Jim Witol, Vice-President Taxation and Research, CLHIA; Jane Voll, Vice-President Policy Development, IBC; Richard Dubin, Vice President Investigative Services, IBC; Deirdre Martin, Senior Counsel, IBC; Neil Skelding, President & CEO, RBC Insurance; Michael Landry, Vice President Corporate Development, Manulife Financial; Moira Gill, Director Insurance regulatory Affairs, TD Financial Group; Bill Pineau, Member relations, LOMA (an international insurance industry association offering market research and education programs targeted to insurance and financial services companies). Represented from the

Toronto Financial Services Alliance were its President, Janet Ecker (former Finance Minister of Ontario) and Susan Viegas, City of Toronto, Economic Development Bureau. Represented on the U.S. side were Consul General Jessica LeCroy, Pol/Econ Consul Sherri Holliday, Pol/Econ Officer Tom Boughter, Pol/Econ Assistant Colin White, and Embassy Ottawa ECON Minister Counselor, Brian Mohler.

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